Oil and Gas Tax Newsletter

NORTH DAKOTA OFFICE OF STATE TAX COMMISSIONER

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LEGISLATIVE CHANGES TO THE GROSS PRODUCTION TAX AND OIL EXTRACTION TAX LAWS

The 1999 Legislative Assembly enacted two bills that change the provisions of the gross production tax and oil extraction tax laws. **SB 1107** relates to the payment and refund of gross production tax and oil extraction tax amounts, which are less than five dollars. **HB 1203** relates to the allocation and distribution of gross production tax revenues that are not accompanied by sufficient information to determine in which county the oil or gas was produced. These changes are described in more detail below.

SB 1107 Payments And Refunds Of Tax Amounts Less Than Five Dollars

A new section to North Dakota Century Code (N.D.C.C.) ch. 57-51 was created and enacted to address the payment and refund of tax amounts that total less than five dollars. The intent was to reduce the costs of processing returns and issuing refunds for minimal tax amounts and to provide consistency with procedures conducted for other tax types. The less than five dollar threshold applies to the total due on a coversheet **not** to each individual lease entry. The effective date of this legislation is August 1, 1999.

The Office of State Tax Commissioner (Commissioner) may not issue a refund to a taxpayer unless the amount to be refunded, including interest, is at least five dollars. The Commissioner must transfer any amounts that are not refunded to the State Treasurer. The funds are deposited and distributed in the same manner as other revenue subject to N.D.C.C. ch. 57-51.

A taxpayer is not required to remit tax, and the Commissioner may not issue an assessment or collect tax, unless the amount due is at least five dollars, including penalties and interest.

This legislation also amended two other sections of N.D.C.C. ch. 57-51. Technical changes to N.D.C.C. § 57-51-05 provided conformity to current drafting standards for legislation and changed the title from "Payment of tax on a quarterly basis" to "Payment of tax on a monthly basis" to correctly reference when tax is to be paid. N.D.C.C. § 57-51-19 was amended to correctly identify the agency that is currently responsible for issuing warrants for refunds. "Upon presentation of the certificate to the state auditor" was replaced with "Upon presentation of the certificate to the office of management and budget".

HB 1203 Allocation Of Oil And Gas Gross Production Tax Revenue

N.D.C.C. § 57-51-16 was amended and reenacted to address the allocation of oil and gas gross production taxes collected from unidentified sources. In certain cases, gross production tax is paid to the Commissioner with accompanying reports that have insufficient information to determine the source of production by county.

The Commissioner accumulates this revenue in an unallocated fund, which is then distributed at the end of each fiscal year. Previously, the entire amount was allocated, and then distributed, to the county that had received the lowest total gross production tax distribution for the fiscal year. After June 30, 1999, all revenue from this unallocated fund will be allocated and distributed to each county in the same proportion as total gross production tax allocations for the fiscal year.

GAS TAX RATE FOR FISCAL YEAR 2000

In keeping with the provisions of N.D.C.C. § 57-51-02.2, the Commissioner has determined that the gas tax rate for the fiscal year beginning July 1, 1999, through June 30, 2000, is $.0405 per mcf. The gross production tax on gas produced during this time period must be calculated by taking the taxable production in mcf times the $.0405 gas tax rate.

The annual average of the gas fuels producer price index was calculated at 76.7. A gas base rate adjustment of 1.0132 was computed by dividing the annual average price index by the denominator specified by statute, (i.e., 76.7 divided by 75.7). The gas rate was then computed by multiplying $.04 times the gas base rate, with the resultant rounded to four places after the decimal, (i.e., .04 times 1.0132).

As required by statute, the gas tax rate and gas base rate adjustment for fiscal year 2000 will be published as a rule in North Dakota Administrative Code § 81-09-02-17 in conjunction with the Commissioner's next rules proceeding.

HOME PAGE

Do not forget to take advantage of the Commissioner's web site at **http://www.state.nd.us/taxdpt.** Instructions, forms, publications, and information for several tax types are available for download or they can be requested online. You will also find information on electronic filing and payment options. Links are available to the State of North Dakota, where other agency links can be found, and to the IRS home pages.

Specific information available from the Oil and Gas Tax Section:

- Oil and gas tax law and rules.
- Oil and gas historical overview.
- Oil producer and purchaser instructions.
- Gas producer and purchaser/processor instructions.
- Pool code and gas plant code lists.
- T-10, T-11, T-12, and T-13 oil and gas tax forms. (These forms are available in a .PDF format, which prints a copy of the form, or you can download a file of the forms in either Excel or Lotus spreadsheet formats.)
- Electronic payment instructions.

ELECTRONIC PAYMENTS

An option is now available for you to make your oil and gas severance tax payments electronically. The Commissioner has implemented a program that allows an Automated Clearing House (ACH) credit to be used for submitting tax payments.

An ACH credit is originated by contacting your bank and providing the Commissioner's bank routing and account numbers and the amount of your payment. You will also need to provide the date you wish the funds to be transferred and other pertinent information to insure that the payment is properly applied to the tax return being submitted. A payment must be initiated by the due date of the return to be considered timely. You will need to check with your financial institution to see if there is a charge to initiate these transactions.

You can find the information needed to start making payments electronically in the Electronic Filing, Oil and Gas Tax, section on the Commissioner's home page. If you have questions regarding electronic payments, please call Kevin Schatz at 701-328-3657 or by E-mail at kschatz@state.nd.us.

SUBMISSION OF GAS TAX

The Commissioner has recently received inquiries regarding the responsibility for submission of gross production tax on gas produced in North Dakota.

N.D.C.C. § 57-51-05 states that on oil or gas sold at the time of production, the gross production tax thereon must be paid by the purchaser, and such purchaser shall and is hereby authorized to deduct in making settlement with the producer or royalty owner, the amount of tax so paid.

The purchaser/processor must file a monthly T-13 Gas Report and remit the tax on all gas delivered to a processing plant, except for gas or gas products physically returned to the lease. The producer/operator must file a monthly T-11 Gas Report and additionally remit the tax on any part of the following categories that are not exempt from the tax:

- Wet gas flared on the lease.
- Wet gas used on the lease.
- Wet gas delivered to a purchaser/processor and physically returned to the lease prior to processing at a gas plant.
- Residue gas and liquid products physically returned to the lease from a gas plant.
- Unprocessed pipeline quality wet gas which is delivered directly into a pipeline system.

A pipeline company, into whose possession unprocessed pipeline quality wet gas is delivered, is required to file a monthly T-13 Gas Report.

A producer/operator is not to remit tax on gas processed at a gas plant.

YEAR 2000 (Y2K)

Year 2000 is less than six months away! The Commissioner has set a target date of September 1, 1999, for completion of the Y2K compliance project. The Commissioner is also in the process of developing contingency plans for all mission-critical business applications.

The State of North Dakota, through the Information Services Division (ISD), has developed a Y2K information page at ***www.state.nd.us/isd/y2k***. You will find information available on various Y2K issues as well as agency status reports, contingency planning, and recommendations and guidelines. If you have questions or concerns regarding Y2K issues contact Becky Herrmann at (701)328-3598 or E-mail at bherrman@state.nd.us.

OIL VALUATION

N.D.C.C. § 57-51-02.3 describes the process of establishing the value of oil at the well. This section is not meant to imply that a sale has to take place at the well, rather it is intended to clarify the steps used to establish gross value at the well. Gross value at the well includes the value of any consideration received from the sale and should be included in determining taxable value. A premium or bonus is considered additional consideration and can be an explicit dollar per barrel amount paid over and above the posted price or can be implicit including an incremental value embedded in a signature bonus, location differential, or an exchange agreement price differential that does not reflect apparent value of the respective crudes.

If the oil is not sold under an arms-length contract at the lease, but is sold off the lease under an arm's-length contract, then transportation costs actually incurred by the producer to move the oil from the point of production to the point of sale under the contract can be deducted from the sales price to establish gross value at the lease. If the oil is not sold at any point under an arm's-length contract, then the first applicable of the three methods given under N.D.C.C. § 57-51-02.3 apply in establishing gross value at the well.

Exchange and buy/sell agreements under which a producer exchanges oil at one location for oil at another location may not represent fair market value. Under exchange or buy/sell agreements where the producer appears to have breached his duty to market oil in an arm's-length manner for the mutual benefit of the producer, the interest owners, royalty owners, etc., gross value may be determined using the first applicable of the three methods given under N.D.C.C. § 57-51-02.3.

Any oil exchanged or transferred to affiliates or subject to multiple exchanges may not be reflective of true gross value at the lease and may not be considered an arm's length sale. For valuation purposes gross value may be determined by using the first arm's-length sales value if applicable or, if no arm's-length sale exists, the first applicable of the three methods given under N.D.C.C. § 57-51-02.3.

NEW DATABASE

The Commissioner is currently in the process of replacing the existing database system used for processing oil and gas returns. This system, which was designed several years ago, compares the information submitted by both the producer and purchaser to identify reporting discrepancies. Legislative changes, allowing the Commissioner to waive a producer's reporting obligation and require purchasers to report electronically, made it necessary to modify or replace the current system.

Major modifications to the current system would have been required, therefore, the Commissioner decided to replace it with a new client server database system. In conjunction, the Commissioner is changing the forms used for reporting oil and gas tax information. Producers and purchasers/processors will use a T-12 Oil Report to report any oil activity and a T-13 Gas Report to report any gas activity. The new forms will also be used to report volume gains, enhanced recovery projects, and reclaimed oil. Certain fields of information have been removed from the forms with some additional information added. The County Summary pages have been eliminated.

When the new database system is completed, the Commissioner will begin to grant a waiver of the filing requirement to producers. In order to receive a waiver, the producer must agree to have the purchaser submit tax due with their return. Applications for a waiver, with instructions, will be mailed to all producers prior to completion of the system so adequate time is available to submit and process them.

The Commissioner plans to offer two forms of electronic filing options to purchasers. The Commissioner will evaluate the resources and capabilities of individual purchasers to determine the acceptable form of electronic media and the timetable for requiring electronic filing. Producers will not be required to file electronically, but will be encouraged to do so if they choose to file returns.

The first option is Electronic Data Interchange (EDI). EDI is currently offered on a voluntary basis utilizing the services of a value added network (VAN). EDI involves the transmission of a file in a nationally approved standard format. The VAN functions as an "electronic mailbox" to send and receive files transmitted electronically. The Commissioner currently pays for the transmission costs involved in electronic filing. The file formats for EDI are being revised to coincide with the form changes being made.

The second option is to utilize an Excel spreadsheet format. The spreadsheet, designed by and available from the Commissioner on disk or by downloading from the home page, will be completed and submitted by the taxpayer via the Internet, other electronic means, or on disk.

Electronic filing provides benefits to both the Commissioner and the taxpayer. Electronic filing involves a computer to computer process and provides for a limited amount of human intervention. This filing procedure results in a decreased number of errors, which eliminates having to file amended returns to make corrections, and also speeds up the entire filing and processing functions. It has been the Commissioner's experience that electronic filing greatly reduces the cost and time involved in processing returns.

The design of the new database is nearly complete and programming is progressing. Testing is scheduled to be completed by the end of the year with the new database going into production shortly after the first of the year.

REMINDERS

To claim an exempt royalty interest, documentation to support a claim must be submitted within ninety days after the first report is filed on a new property.

Producers are encouraged to review production and reporting history and take full advantage of tax incentives by receiving certifications from the Industrial Commission. It is the producer's responsibility to make certain that the Commissioner receives a copy of the certification within the 18-month deadline. It is advisable to phone this office when the 18-month deadline is approaching and a producer is not certain that a certification has been received by the Commissioner.

To verify an API number, well code, or other information relating to an existing well, call Pat Wirta at (701)328-2747. Any oil producer or purchaser filing a report on a particular well for the first time is especially encouraged to contact Pat for information on the wells current tax status.

Please do not send returns by fax, they will not be accepted. The Commissioner will only accept replacement pages by fax when an error has been discovered prior to processing a return.

Each operator of an oil pipeline must file a report showing its volume gains and volume losses for the calendar year. The report can be filed in the form of the pipeline's "over and short" reports compiled during the ordinary course of business. These reports are due by the twenty-fifth of February following the end of calendar year.

An oil purchaser, that has incurred a volume loss resulting from differing measurements of oil, can offset a volume gain in subsequent periods as follows:

a. For a volume loss carried forward after December 31, 1996, an oil purchaser may utilize a loss to offset a gain at any trunkline measurement point. A volume loss carried forward after December 31, 1996, must be utilized on a first in-first out basis before January 1, 2000.

b. For a volume loss which is incurred after December 31, 1996, an oil purchaser may utilize the loss to offset a gain at another trunkline measuring point. A volume loss which is incurred after December 31, 1996, may be carried forward for three years after the due date of the return for the production month in which the loss was incurred.

If You Need Assistance

If you have additional questions about the oil and gas tax requirements, please contact:

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